



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

- MPC raised interest rates by 25 bps. Repo rate now 4.25%
 - Fairly hawkish communiqué contradicted by dovish statements by MPC members
 - New inflationary projection lower than in April, but still shows the CPI permanently above 2.5% from mid-2008
 - Important March data were not included in the estimation sample
 - We think the hike was the beginning of a tightening cycle, next hike in July
 - Retail sales grew by 19.2%, prices in retail trade rise yet again
 - Unemployment rate dropped to 14.4%
 - All 5 core inflation measures rose in March
 - 16.5-19% budget deficit execution after April expected. CIT income shift should boost April income
 - Social security fees to be reduced in July 2007 and January 2008
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FIXED INCOME

- Sell short, pay 9 months and 1 year in OIS
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FI RECOMMENDATION

- Stay with pay position

MONEY MARKET

- Very cheap end of the reserve
 - T-bills to go up at Monday's tender
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- Sell short, pay 9 months and 1 year in OIS

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- Zloty stable
- Short Gamma

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MACROECONOMICS

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Fairly hawkish communiqué contradicted by dovish statements by MPC members

New inflationary projection lower than in April, but still shows the CPI permanently above 2.5% from mid-2008

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Retail sales grew by 19.2%, prices in retail trade rise yet again

As expected, the MPC decided to raise official interest rates by 25 bps, to 4.25% for the repo rate. The communiqué after the meeting was fairly hawkish, stating that, "In the Council's assessment, in the medium term, the probability of inflation running above the target is larger than the probability of it running below the target". Moreover, the MPC expects the pace of growth to exceed potential in the coming quarters, which should lead to a rise in wage and inflationary pressure.

The communiqué, however, was contradicted by statements made during the press conference. NBP President S. Skrzypek stressed that the hike should not be considered the beginning of the tightening sequence, and Prof. Sławiński added that the hike has a preemptive character.

Also, statements made by hawkish MPC members confirmed that view. H. Wasilewska-Trenkner indicated that the decision was necessary to ensure that the MPC is aware of some inflationary tensions. D. Filar added that the decision resulted from the worry that the CPI may rise significantly next year.

The decision to hike rates was partly based on the new inflationary projection. Even though in the whole projection horizon the central CPI path is lower than in the January projection, it still shows the CPI will permanently exceed 2.5% in 2008. Also, the changes introduced to the projection (most importantly to the labour market module) make it more credible among MPC members. The projection forecasts the CPI to remain below the 2.5% target during the whole of 2007. 2.5% is to be reached in Q2 2008, after that a steady rise to ca. 3.5% at the end of 2009 is expected.

It must, however, be indicated, that the cut-off date was set at 23rd March. After that time a number of pieces of information significantly increased inflationary risks – March CPI was higher than expected, fuels prices rose and will most likely remain above NBP forecasts, and wages growth was significantly higher. Moreover, the projection did not include the government proposals to reduce the tax wedge this year. Altogether, the April projection is probably overly optimistic regarding the future inflation outlook and the July projection should be significantly higher.

Our comment:

In our opinion the decision to hike rates in April may be the beginning of a tightening cycle. In our opinion, the coming data will indicate higher inflation and growth rates than the ones included in the inflationary projection. Also, the projection to be presented in July will most likely be significantly higher than the present one. We expect the next 25 bps hike to take place in July. We expect one more hike in the autumn, and we also think the MPC will raise interest rates by an additional 75 bps next year.

Although we may expect more dovish comments by the MPC members in the coming weeks, we think the majority of the MPC members is aware that stronger hikes are needed, as was stated in the communiqué.

Retail sales in March rose by 19.2% y/y, notably above market expectations. This indicates that the GDP growth in Q1 reached 7.5-7.6% y/y, with a significant private consumption growth. The data show one more phenomenon – prices in the retail trade rose yet again (real growth was 17.6%). Since the structure of the retail sales basket is different to CPI, this may be regarded as another indication of arising inflationary pressure. Dropping prices of tradable goods no longer makes up for a stronger rise in the non-tradable sector. This may lead to a more significant rise in CPI – 2.6% at the end of 2007 and up to 3% in 2008.

Unemployment rate dropped to 14.4%

The unemployment rate in March dropped to 14.4% (14.9% in February). The drop was in line with preliminary estimates by the Ministry of Labour. The number of unemployed dropped by 98.7k (in previous years the drop did not exceed 45k). In April we expect the unemployment rate to drop to 13.8%.

It is worth noting that the significant part of the unemployment rate is now structural. GUS reported that 64% of the unemployed have, at most, vocational education, and we think the majority of them have very low potential to learn new skills and are unlikely to be regarded as potential employees. Tensions on the labour market should, in our opinion, lead to even stronger wage pressure, which must be considered a major risk factor by the MPC.

All 5 core inflation measures rose in March

In March all 5 core inflation measures rose compared to February. Net inflation rose to 1.7% from 1.6%. A more significant rise was observed in inflation net of controlled prices (1.8% to 2.3%). The rise was largely caused by a rise in services prices. In April net inflation may drop to 1.4% due to base effect, but it is widely anticipated by market participants and therefore this should not change the inflation outlook in Poland.

16.5-19% budget deficit execution after April expected. CIT income shift should boost April income

The MF stated that the preliminary budget deficit execution estimates show a rise to 16.5-19% (16.1% after March). This would imply monthly deficit of not more than 900 m PLN, again below expectations from the budget schedule. The actual execution may turn out even lower as we expect higher CIT income in April. Usually the annual CIT payments were to be made by the end of March (which led to a record-high CIT income in March). This year this period was prolonged to 2nd April, which should also result in a shift in budget income.

Social security fees to be reduced in July 2007 and January 2008

In addition the government approved MF proposals to reduce pension insurance fees. The fees are to be reduced by 3 pct pts from July 2007 and by a further 4 pct pts from January 2008. The estimated cost will reach 3 b PLN in 2007 and 17 b in 2008 (after dynamic effects are taken into consideration, this may drop to a total of 14 b). As announced by Finance Minister, Z. Gilowska, the time required to implement changes in the ZUS IT system should not exceed a few weeks, which should allow for execution of the programme.

The cut should have a significant impact on consumption beginning from Q3 2007. The currently observed record-high labour fund growth will therefore have a visibly greater impact on the disposable income of households. We expect that the consumption contribution to GDP growth should be visibly higher than last year.

FIXED INCOME

First hike!

Last week main event was Wednesday hike by MPC, widely expected 25 bp. The reaction was very tamed, but we saw some nervous just after the hike decision was announced. 9x12 FRA were paid at 4.90 3x6 at 4.65. The statement on the conference itself was in our opinion hawkish at least enough to keep the market dynamics. But one sentence from CB governor Skrzypek "this hike doesn't start the cycle", made market change the mood by 180 degrees. We quite don't understand why... We are looking at two things right now. First is figures from real economy, and in our opinion will be high, pointing that second quarter will be not slower than 1st quarter. We also look at wages, and it cannot be excluded they will be rising in double digits in some months this year. Generally we look at very substantial rise in domestic demand. We think that even with dovish MPC, rates will need to push higher, as right now the main threat underlined by MPC members is fact that GDP may be growing close or above potential, especially that

RECOMMENDATION:

growth will be now not exports but consumption driven. Our strategy is unchanged from last months, we prefer to stay with pay position. We now recommend paying spread 6x9 ag 9x12 FRA currently trading around 9 bp. We also recommend staying long 2y IRS currently trading at 4.90.

Stay with pay position

MONEY MARKET

*Too small open market operation
Very cheap end of the reserve*

The MPC raised all the rates by 25 bps

T-bills to go up at Monday's tender

RECOMMENDATION:

The central bank offered 23.4 billion PLN of money bills (17.4 billion was coming back from maturing papers on Friday). Short rates decreased at the end of the day. Last days of the reserve were very cheap. At the end of the last reserve day the market placed in the CB over 3 billion PLN, which best visualizes the scale of surplus.

Poland's central bank raised its main interest rate by a quarter point on Wednesday in its first tightening in almost three years as a pre-emptive strike.

The average yield on the Polish benchmark 52-week T-bill rose to 4.419% at Monday's auction from 4.373% at the previous tender April 2. The ministry sold all 900 million zlotys of 52-week papers on offer at moderately bid tender. Bids for 52-week paper totaled PLN 1.15 billion, giving a bid-to-cover ratio of 1.3, down from 1.7.

Sell short, pay 9 months and 1 year in OIS.

FOREIGN EXCHANGE

Zloty stronger

Volatility stable

RECOMMENDATION:

Zloty stable

Last week the Zloty traded stable at a narrow range of 3.7700-3.7800. As EUR/USD reached new highs of 1.3660, the USD/PLN traded between 2.7630-2.7750 most of the time.

The implied volatilities seem to have reached their supports: EUR/PLN traded flat at 5.9-6.0 despite the fact that 1M realized volatility is at its long-time low of 3.75! USD/PLN remained almost flat at 7.5

Spot:
Main supports / resistances:
EUR/USD: 1.3550 / 1.3650

Short Gamma

EUR/PLN: 3.7800 / 3.8000
USD/PLN: 2.7600 / 2.8000

In the following week we still may see Zloty trade within a range. The correction is still possible, but because we see a lot of the EUR sellers, the magnitude of the potential correction should be of small relevance. We recommend selling EUR/PLN on tops this week.

Options:

Given that EUR/PLN still remains within a range and realized volatility is very low by historical comparison, we still recommend being short Gamma.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
23-04-07	4.32%	4.35%	4.48%	4.53%	4.72%	4.74%
24-04-07	4.32%	4.35%	4.47%	4.53%	4.69%	4.74%
25-04-07	4.32%	4.35%	4.47%	4.54%	4.69%	4.74%
26-04-07	4.36%	4.38%	4.49%	4.55%	4.69%	4.75%
27-04-07	4.36%	4.40%	4.49%	4.55%	4.70%	4.75%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	23-04-07	4.45%	4.62%	4.78%	4.88%
24-04-07	4.46%	4.63%	4.78%	4.88%	4.86%
25-04-07	4.46%	4.63%	4.78%	4.88%	4.86%
26-04-07	4.45%	4.60%	4.76%	4.86%	4.86%
27-04-07	4.45%	4.59%	4.76%	4.85%	4.86%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK1208	IRS	PS0511	IRS	DS1017
23-04-07	4.74%	4.38%	4.94%	4.65%	5.16%	5.11%	5.24%	5.30%
24-04-07	4.74%	4.39%	4.94%	4.64%	5.16%	5.10%	5.24%	5.30%
25-04-07	4.74%	4.43%	4.92%	4.64%	5.15%	5.10%	5.24%	5.30%
26-04-07	4.75%	4.44%	4.92%	4.65%	5.16%	5.10%	5.25%	5.31%
27-04-07	4.75%	4.43%	4.91%	4.61%	5.16%	5.11%	5.24%	5.31%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-04-02	08-04-02	95.766	4.37%	900	1543	900
OK0709	07-04-04	09-07-25	89.970	4.69%	1000	2463	1000
PS0412	07-04-18	12-04-25	98.416	5.11%	1800	8876	1800
DS1017	07-04-11	17-10-25	99.976	5.24%	1800	3473	1800

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
23-04-07	7.50	7.50	7.50	7.50	1.20	1.30	0.35	0.60
24-04-07	7.50	7.50	7.50	7.50	1.20	1.30	0.35	0.60
25-04-07	7.50	7.50	7.50	7.50	1.20	1.30	0.35	0.60
26-04-07	7.20	7.45	7.55	7.70	1.20	1.30	0.35	0.60
27-04-07	7.20	7.45	7.55	7.70	1.20	1.30	0.35	0.60

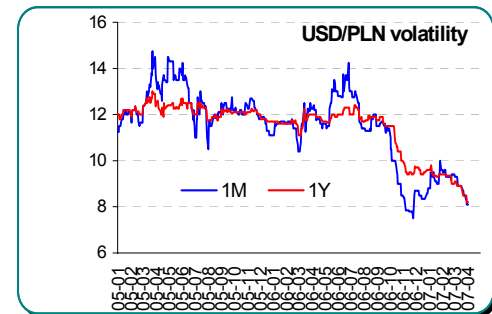
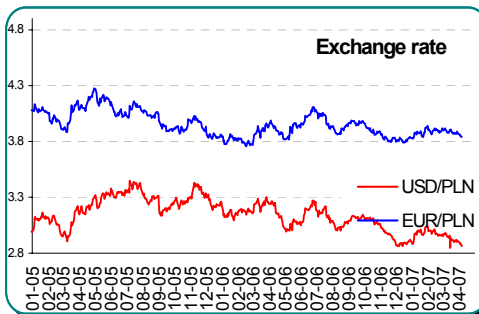
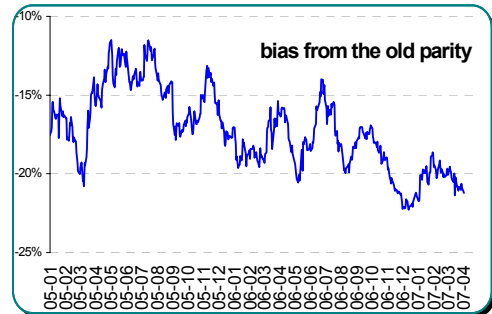
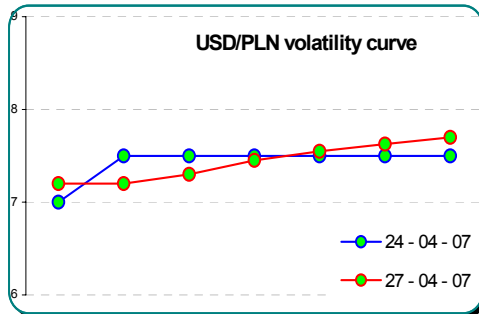
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
23-04-07	3.7797	2.7866	-23.84%
24-04-07	3.7880	2.7925	-23.67%
25-04-07	3.7884	2.7741	-23.89%
26-04-07	3.7746	2.7668	-24.13%
27-04-07	3.7800	2.7767	-23.95%

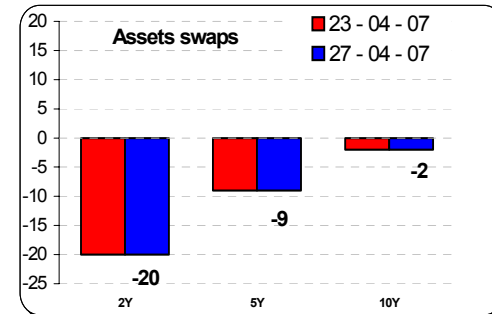
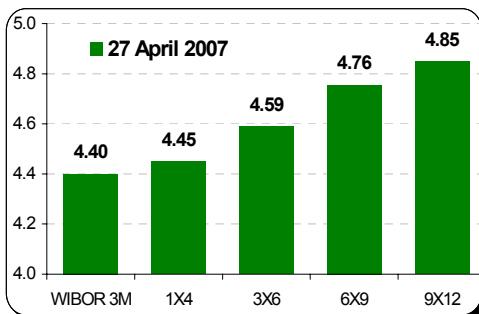
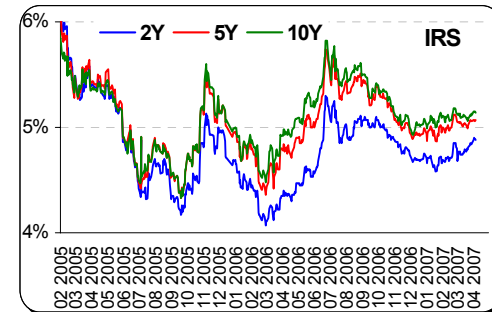
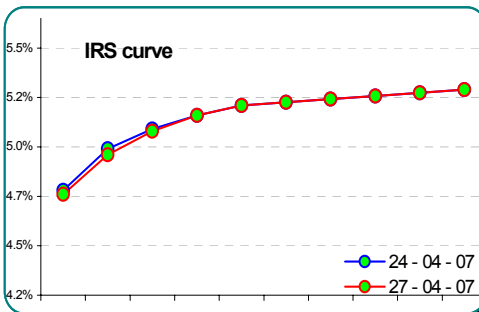
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	January	February	March	Data Release	BRE Bank forecast
CPI m/m	0.4%	0.3%	0.5%	15-05-07	
CPI y/y	1.6%	1.9%	2.5%	15-05-07	
PPI m/m	0.6%	0.3%	0.5%	21-05-07	
PPI y/y	3.1%	3.5%	3.3%	21-05-07	
Industrial production growth m/m	0.2%	-2.1%	14.7%	21-05-07	
Industrial production growth y/y	15.4%	13.0%	11.3%	21-05-07	
Average wages in enterprise sector [PLN]	2663.6	2687.5	2852.7	17-05-07	
Average wages in enterprise sector y/y	7.8%	6.5%	9.1%	17-05-07	
Unemployment	15.1%	14.9%	14.4%	25-05-07	
Budget realisation (%)	-10.3%	10.1%	16.1%	15-05-07	
Current account [EUR mn]	-733	-424		18-05-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-398	-60		18-05-07	
Exports growth y/y (transaction basis)	15.5%	16.3%		18-05-07	
Imports growth y/y (transaction basis)	21.5%	13.4%		18-05-07	
Current account [% of GDP]	-2.1%	-2.2%		18-05-07	
Money supply (M3)	485.3	490.6	492.7	14-05-07	
Money supply growth y/y	19.3%	17.9%	18.1%	14-05-07	
Total PLN loans [PLN bn]	376.6	383.6	392.4	14-05-07	
Households PLN loans	194.2	197.1	203.6	14-05-07	
Corporate PLN loans	144.4	148.2	151.4	14-05-07	
Total PLN deposits [PLN bn]	404.7	410.7	410.9	14-05-07	
Households PLN deposits	226.3	228.6	227.1	14-05-07	
Corporate PLN deposits	124.1	126.1	125.5	14-05-07	
NBP intervention rate	4.00%	4.00%	4.25%	30-05-07	4.25%

Auctions

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	16-01-06
26 Week T-bills	-	-	3.943%	24-04-06
52 Week T-bills	07-05-07	900	4.419%	23-04-07
2Y T-bond OK1208	06-06-07	-	4.694%	04-04-07
5Y T-bond PS0412	16-05-07	-	5.111%	18-04-07
10Y T-bond DS1017	11-11-07	-	5.244%	11-04-07
20Y T-bond WS0922	12-09-07	-	5.309%	14-03-07

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